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Ethiopia

Summary Findings

- Ethiopia's tax revenues were eroded by an amount equivalent to three percent of GDP between 2005 and 2009, but began to recover in 2010 after improvements in the VAT due to better cash register coverage, following the currency devaluation of 2010, and after the effects of the drought of 2007/2008 subsided.
- Ethiopia's 2010 tax reform strategy aims at reviewing exemptions and exemption approval procedures, consolidating collections, and increasing resources for audit and enforcement of large taxpayers.
- Ethiopia's revenue effort and revenue productivity from the corporate income tax is slightly below that of African comparator countries and significantly lower than that of low-income countries in other regions.
- Ethiopia's revenue effort and revenue productivity from its personal income tax and VAT are extremely weak in comparison to the corresponding levels in other low-income countries in Africa and worldwide.

Major Developments and Features of Current Tax System

Evolution of Revenue

Ethiopia mobilized tax revenue at 11.9 percent of GDP in 2002 following major tax reforms in 2001 and 2002. Between 2005 and 2009, Ethiopia's tax revenues declined by an amount equal to 3 percent of GDP, with large declines in revenue from income taxes and import tariffs. In 2010, revenues were boosted by currency devaluation and by rebound effects following a drought¹ and the global financial crisis, and the government began implementation of a new tax reform strategy as discussed below.

Ethiopia: Government Budget Current Revenue (% GDP)

| | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
|------------------------------|-------|-------|-------|-------|-------|-------|------|------|-------|-------|
| Total tax revenue | 11.9% | 11.2% | 12.6% | 11.6% | 10.8% | 10.1% | 9.6% | 8.6% | 11.3% | 11.5% |
| Personal income tax | 1.2% | 1.2% | 1.2% | 1.2% | 0.6% | 0.6% | 0.5% | 0.5% | 0.3% | |
| Corporate income tax | 2.6% | 2.4% | 1.6% | 1.7% | 0.9% | 1.0% | 1.0% | 1.1% | 1.8% | |
| Value added tax | 0.9% | 0.7% | 0.1% | 1.2% | 1.1% | 1.1% | 1.0% | 1.2% | 1.6% | |
| Excise taxes | 0.9% | 0.5% | 0.5% | 0.4% | 0.5% | 0.3% | 0.4% | 0.3% | 0.4% | |
| Taxes on international trade | 5.0% | 4.9% | 6.1% | 5.4% | 5.0% | 4.8% | 4.7% | 3.5% | 4.6% | 4.9% |

Source: IMF

¹ Ethiopia has experienced recurring severe droughts – in 2002/2003, 2007/2008, and 2011.

Ethiopia experienced sustained strong real GDP growth of over 10 percent on average between 2004 and 2011 driven in part by high levels of public investment. Public capital expenditures averaged 10.3 percent of GDP in 2010-2012 and are planned at 9.5 percent of GDP on average for 2013-2017. High public investment, coupled with declining levels of external grants – 3.2 percent of GDP in 2011 and projected to 1.3 percent in 2013 – lead the need for expanded own-source revenue. However, Ethiopia's economy is largely based on agriculture – 46 percent of GDP and 85 percent of employment – which reduces the 'tax handles' that are available to the state.

Summary of Reforms

The current tax system in Ethiopia is relatively new. Major reforms of the tax system in Ethiopia took place in 2002 and 2003. In 2002, Ethiopia introduced a progressive tax rate schedule for certain incomes, completed a 10-year effort to modernize customs tariff schedules, and instituted an improved enforcement mechanism for tax debts that were previously collected only through judicial proceedings. In 2003, Ethiopia replaced the sales tax with VAT (and a turnover tax for businesses below the VAT registration threshold), introduced improved administrative processes and performance measures, established new branch offices, and introduced taxpayer identification numbers.

Subsequent reforms were piece-wise, aimed primarily at strengthening the revenue administration with a functional organization and centralizing and strengthening regional offices. However, Ethiopia provided tax amnesties, which weakened taxpayer compliance, and extended new investment incentives that eroded the buoyancy of tax revenue. A number of tariff exemptions and holidays were introduced through revisions of Ethiopia's investment law, including one in 2002 and another in 2012.

In 2010, Ethiopia developed a tax reform strategy with IMF technical assistance. The strategy aimed at reviewing exemptions and exemption approval procedures, consolidating collections, and increasing resources for audit and enforcement of large taxpayers. In 2010, Ethiopia also increased the coverage of the cash register system for VAT.

Tax System Profile (2011-12)

The discussion below provides a high-level profile of Ethiopia's tax system and compares Ethiopia with other low income countries in Sub-Saharan Africa and the rest of the world.

Revenue Performance

- Ethiopia's revenue effort from corporate income taxes is slightly below the corporate income tax effort of other low income countries in Sub-Saharan Africa and well below the world average.
- The revenue effort from the personal income tax is extremely low, compared to both low income countries in Sub-Saharan Africa and in other regions.
- The VAT revenue effort is also far below that of comparator countries in the region and world-wide.

Tax Structure

- Ethiopia's corporate income tax rate (30 percent) is in line with that of low income countries in Sub-Saharan Africa peers (31.7 percent) and somewhat higher than the world average (25.7 percent).
- The maximum personal income tax rate (35 percent) is in line with comparator countries in Sub-Saharan Africa (35.4 percent) and somewhat higher than the world average (27.8 percent).
- The VAT rate is at 15 percent, slightly lower than that of comparator countries in the region and the world average (15.7 and 15.5 percent respectively).

Revenue Productivity

- The corporate income tax productivity is in line with low income countries in Sub-Saharan Africa, but distinctly lower than the average in other regions.
- The personal income tax productivity is extremely low compared to that in other low-income countries in the region and in the world.
- The VAT revenue productivity is significantly lower than that of comparator countries in the region and the world.

Taxpayer Burden and Corruption Evidence

- Enterprise surveys by the World Bank indicate that the percentage of Ethiopia's business taxpayers "expected to give gifts in meeting with tax officials" is 3.8 percent, which is well below the regional average of 18.2 percent and the world average of 14.2 percent. (The latest survey in Ethiopia was in 2011).
- The World Bank Doing Business survey estimates that the average time required for Paying Taxes by a medium-sized company in Ethiopia amounts to 306 hours per year in 2013, which is in line the average of 320 hours for other countries in Sub-Saharan Africa.

ANNEX: Ethiopia's Collecting Taxes Indicators

| Company Income Tax | CITR Tax Rate | CITY Revenue as percent GDP | CITPROD Revenue Productivity |
|--|------------------|-----------------------------------|---------------------------------|
| Ethiopia | 30.0 | 1.8 | 0.06 |
| Sub-Saharan Africa Low Income Economies | 31.7 | 2.1 | 0.07 |
| Sub-Saharan Africa | 31.5 | 3.0 | 0.10 |
| Low Income Economies | 29.0 | 2.4 | 0.09 |
| World | 25.7 | 3.3 | 0.14 |

| Income Taxes on People | PITMINR Minimum Tax Rate | PITMINL Minimum Income Level (Multiples of GDP _{pc}) | PITMAXR Maximum Tax Rate | PITMAXL Maximum Income Level (Multiples of GDP _{pc}) |
|--|--------------------------------|---|--------------------------------|---|
| Ethiopia | 10.0 | 0.40 | 35.0 | 13.27 |
| Sub-Saharan Africa Low Income Economies | 9.7 | 2.63 | 35.4 | 14.7 |
| Sub-Saharan Africa | 10.3 | 2.02 | 34.0 | 11.9 |
| Low Income Economies | 8.9 | 2.04 | 31.0 | 26.8 |
| World | 10.9 | 0.87 | 27.8 | 10.7 |

| Income Taxes on People | PITY Revenue as percent GDP | PITPROD Revenue Productivity |
|--|-----------------------------------|------------------------------------|
| Ethiopia | 0.3 | 0.01 |
| Sub-Saharan Africa Low Income Economies | 3.6 | 0.12 |
| Sub-Saharan Africa | 4.1 | 0.13 |
| Low Income Economies | 3.7 | 0.14 |

| | | |
|-------|-----|------|
| World | 4.5 | 0.17 |
|-------|-----|------|

| Value Added Tax | VATR VAT rate | VATY Revenue as percent GDP | VATGGR Gross Compliance Ratio | VATPROD Revenue Productivity | THRESHOLD Mandatory Registration/ Filing (annual Turnover in USD) |
|---|------------------|--------------------------------------|--|------------------------------------|---|
| Ethiopia | 15.0 | 1.9 | 14.2 | 0.13 | 58,000 |
| Sub-Saharan Africa Low Income Economies | 15.7 | 5.2 | 42.5 | 0.31 | 45,040 |
| Sub-Saharan Africa | 15.4 | 5.3 | 48.8 | 0.34 | 47,367 |
| Low Income Economies | 14.8 | 5.1 | 48.3 | 0.34 | 53,362 |
| World | 15.5 | 6.2 | 63.1 | 0.41 | 59,265 |